

# Executive Summary

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General Fund receipts totaled \$1,965.7 million for the first quarter of fiscal year 2006 (FY06), increasing from FY05 by 11.6 percent. This represents \$204.3 million more than reported in the same period one year earlier. The Road Fund rose by 6.6 percent during the first quarter, and economic growth as measured by Kentucky personal income, was up by 5.9 percent.

Performance in the General Fund categories for the first quarter was affected not only by economic conditions but also by changes enacted in HB 272 (*JOBS for Kentucky*). Sales and use tax revenues were up by 6.4 percent. Individual income tax receipts rose by 3.4 percent, dampened by tax cuts that began to take effect in July. Corporation income and license taxes posted sharp growth of 59.2 percent reflecting both the strength of the economy and the shift in revenues away from individual income taxes and into the corporation income tax for pass-through entities.

Coal severance taxes rose by 22.0 percent continuing their strong recent performance. Cigarette taxes, boosted by an increase in the rate and the final installment payments for the floor stocks tax, were up by 1,332.5 percent in the first quarter of FY06. Property taxes were 38.6 percent higher than a year earlier, due principally to timing differences in collection of some accounts.

During the first quarter of FY06, lottery revenues fell by 17.8 percent compared to the first quarter of FY05. Receipts a year earlier were extraordinarily high due to large sales of Powerball tickets earlier in the summer. Such sales did not re-occur in the summer of 2005. All other receipts combined for a decline of 4.7 percent.

Road Fund receipts were boosted by a recalculation of the statutory rate of motor fuels taxes, which are tied to the wholesale price of motor fuels. For the first quarter, these taxes rose by 6.8 percent. Motor vehicle usage tax receipts climbed by 7.4 percent as manufacturer discounts boosted new motor vehicle sales.

Weight distance tax revenues rose by 4.0 percent, and motor vehicle license tax revenues fell by 2.6 percent. Motor vehicle operators license tax rose by 99.6 percent due to an increase in drivers' license fees.

The U.S. economy as measured by real gross domestic product (GDP) expanded by 3.5 percent in the first quarter of FY06 despite shocks to the system from Hurricanes Katrina and Rita. Personal income also rose by a healthy 6.2 percent, but was only slightly higher than inflation. Kentucky's economy as measured by personal income grew by 5.9 percent over the same period one year earlier.



Employment in the state grew by 1.3 percent as 22,500 jobs were added to the payroll during the first quarter.

The interim forecast for the General Fund expects revenues to rise by 5.7 percent over the final three quarters of FY06. Total revenues for the entire fiscal year are forecasted to reach \$8,184.9 million, which is \$359.9 million more than the official estimate. This interim forecast is identical to that approved by the Consensus Forecasting Group on October 11. Changes in tax laws brought about in *JOBS for Kentucky* will affect revenues over the remainder of the fiscal year.

Among the major accounts, the outlook for the next three quarters is for sales and use tax revenues to rise by 3.7 percent, the individual income tax to decline by 7.0 percent, corporation income and license taxes to grow by 51.6 percent, and coal severance tax receipts to expand by 11.8 percent.

The cigarette tax was most affected by an increase in the rate from 3 cents per pack to 30 cents, (including one cent that does not flow to the General Fund) and revenues are estimated to grow by 317.5 percent in the last nine months of FY06. Property tax

receipts will rise by 1.9 percent, and dividend payments from the lottery should rise by 5.8 percent. “Other” taxes and revenues will combine for an increase of 11.1 percent during the final three quarters due primarily to new taxes created in *JOBS for Kentucky* on telecommunications services and other tobacco products.

The interim outlook for the Road Fund anticipates an increase in revenues of 4.8 percent for the last three quarters of FY06. Revenues should exceed the official estimate by \$29.4 million. Motor fuels taxes will grow by 6.8 percent chiefly due to the higher rate on gasoline and other motor fuels. Motor vehicle usage tax collections are expected to rise by 1.2 percent, and motor vehicle operators’ license fees are projected to expand by 196.3 percent because of an increase in the fee effective this fiscal year.

The outlook for the national economy foresees real GDP growth of 3.4 percent over the remainder of FY06, and personal income growth of 6.0 percent. In Kentucky, personal income is expected to rise by 5.1 percent, while employment should rise by 1.3 percent or 23,500 jobs.



# Revenue Receipts

## First Quarter FY2006

### GENERAL FUND First Quarter, FY06

General Fund receipts in the first quarter of FY06 totaled \$1,965.7 million compared to \$1,761.4 million in the first quarter of FY05, for a net gain of \$204.3 million and growth of 11.6 percent. Collections in the major revenue categories are shown in summary form in Table 1. Detailed information on these and other accounts is available in the Appendix.

Table 1  
Summary General Fund Receipts  
First Quarter, FY06  
(mil \$)

	FY06	FY05	Diff (\$)	Diff (%)
Sales and Use	685.5	644.4	41.1	6.4
Individual Income	766.8	741.6	25.2	3.4
Corp. Inc. & License	209.3	131.5	77.8	59.2
Coal Severance	52.3	42.9	9.4	22.0
Cigarette Taxes	53.3	4.0	49.3	1,332.5
Property	53.4	38.6	14.8	38.6
Lottery	37.0	45.0	-8.0	-17.8
Other	<u>108.1</u>	<u>113.4</u>	<u>-5.3</u>	<u>-4.7</u>
<b>TOTAL</b>	<b>1,965.7</b>	<b>1,761.4</b>	<b>204.3</b>	<b>11.6</b>

Changes in tax laws due to the passage of HB 272 (*JOBS for Kentucky*) had an impact on collections during the first quarter. Principal changes affecting revenues were in the areas of the cigarette tax, and individual as well as corporation income taxes. These changes will be discussed below in the appropriate category.

The **sales and use tax** had robust growth of 6.4 percent in the first quarter of FY06.

Receipts of \$685.5 million compare to the \$644.4 million collected in the first quarter of FY05.

**Individual income tax** receipts gained 3.4 percent in the first quarter of FY06. Receipts of \$766.8 million were \$25.2 million more than was collected in the first quarter of the previous fiscal year. Changes enacted by *JOBS for Kentucky* shifted some receipts from this source to the corporation income tax.

**Corporation income and license taxes** posted strong growth of 59.2 percent during the first quarter of FY06. Receipts totaled \$209.3 million compared to the \$131.5 million received a year earlier. Corporation income taxes were boosted by the shift in revenues from the individual income tax.

The **coal severance tax** continued its recent history of strong growth by climbing 22.0 percent in the first quarter. Coal prices have escalated sharply in tandem with other energy prices, and this has boosted severance tax revenues. Receipts of \$52.3 million compare to \$42.9 million collected in the first quarter of FY05.

**Cigarette taxes** rose sharply in the first quarter affected by the changes enacted by *JOBS for Kentucky*. Receipts of \$53.3 million were 1,332.5 percent greater than collected in the first quarter of FY05. Cigarette taxes included in the General Fund include the original cigarette excise tax of 3-cents per pack and two taxes enacted in the most recent General

Assembly: the 26-cent per pack surtax, and the cigarette floor stock tax.

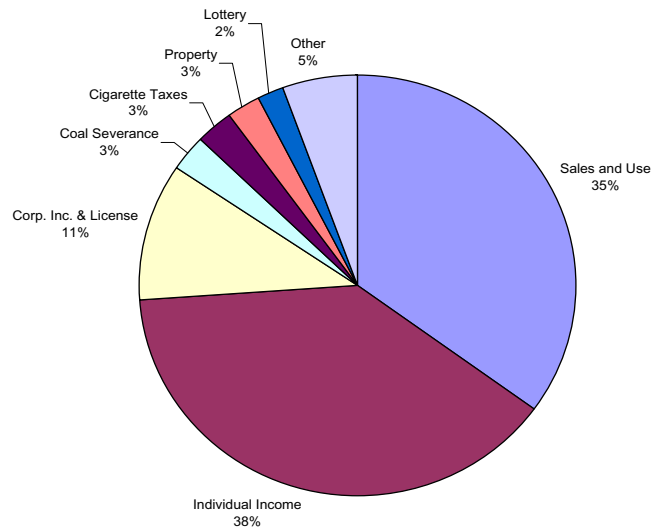
**Property taxes** were up by 38.6 percent in the first quarter of FY06 due almost entirely to differences in the timing of collections. Collections of \$53.4 million compare to \$38.6 million received in the first quarter of the prior fiscal year.

**Lottery** receipts fell by 17.8 percent in the first quarter of FY06 with revenues of \$37.0 million. Lottery revenues were affected by strong Powerball sales in the first quarter last fiscal year.

The “**other**” category represents the remaining accounts in the General Fund, and collections in this account fell 4.7 percent with receipts of \$108.1 million.

Figure 1 details the composition of first-quarter General Fund receipts by tax type. Over 73 percent of General Fund revenues were in the areas of the individual income tax and the sales tax. The next-largest source of revenue was the combination of the corporation income tax and the corporation license tax at 11 percent. “Other taxes” combine for the next-largest source with growth of 5 percent. The components in this category include inheritance taxes, insurance premium taxes, beer wholesale sales tax, the natural gas severance tax, departmental fees, and fines and forfeitures. Coal severance taxes, property taxes, and cigarette taxes each made up three percent of the General Fund. Lottery revenues were two percent of the General Fund.

**Figure 1**  
**First Quarter, FY06**  
**General Fund Receipts**



## ROAD FUND

### First Quarter, FY06

The Road Fund posted growth of 6.6 percent in the first quarter of FY06. Receipts totaled \$304.7 million compared to the \$285.9 million received in the first quarter of the last fiscal year. Summary data are contained in Table 2 and detailed data are shown in the Appendix.

**Motor fuels and motor fuels use tax** receipts increased 6.8 percent during the first quarter of FY06. Receipts were \$135.6 million and compare to \$127.0 million collected during the first quarter of last year. Motor fuels tax revenues were affected by an increase in the motor fuels rate that was not in effect in the previous fiscal year.

**Table 2**  
**Summary Road Fund Receipts**  
**First Quarter, FY06**  
**(mil \$)**

	<b>FY06</b>	<b>FY05</b>	<b>Diff (\$)</b>	<b>Diff (%)</b>
Motor Fuels & MF Use	135.6	127.0	8.6	6.8
Motor Vehicle Usage	117.6	109.5	8.1	7.4
Weight Distance	21.6	20.8	0.8	4.0
License	3.3	1.6	21.8	99.6
Motor Vehicle License	16.4	16.8	-0.4	-2.6
Investment Income	0.7	0.9	-0.2	-19.6
Other	<u>9.5</u>	<u>9.3</u>	<u>0.2</u>	<u>2.2</u>
<b>TOTAL</b>	<b>304.7</b>	<b>285.9</b>	<b>18.8</b>	<b>6.6</b>

**Motor vehicle usage tax** receipts grew by 7.4 percent during the first quarter. Receipts were \$117.6 million compared to \$109.5 million collected during the same period last year. Motor vehicle usage taxes were affected by dealer and factory incentive programs.

**Weight distance tax** receipts of \$21.6 million grew by 4.0 percent over receipts of \$20.8 million during the first quarter of last year.

**Motor vehicle operators' license fees** rose by 99.6 percent due to an increase in the fee enacted by the 2005 General Assembly.

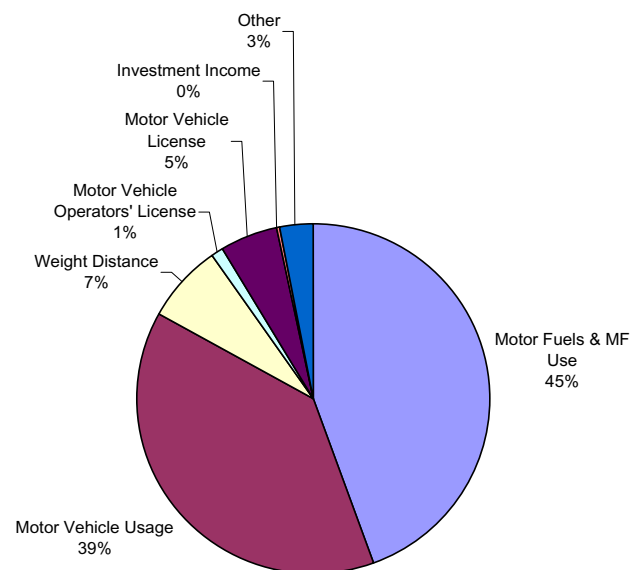
**Motor vehicle license tax** receipts fell by 2.6 percent during the first quarter of FY06. Receipts of \$16.4 million compared to \$16.8 million received during the first quarter of FY05.

**Investment income** fell 19.6 percent in the first quarter, yielding approximately \$724,000 versus \$900,000 in the first quarter of FY05.

The remainder of the accounts in the Road Fund combined for an increase of 2.2 percent. Receipts for the "Other" category totaled \$9.5 million during the first quarter, compared to \$9.3 million in the first quarter of FY05.

Figure 2 details the composition of Road Fund revenues by tax type in the first quarter of FY06. Motor fuels taxes and motor vehicle usage taxes comprised 84 percent of Road Fund revenues in the first quarter. The next-largest source of revenue was the weight distance tax with 7 percent, followed by motor vehicle license with 5 percent. The "other" category accounted for 3 percent, and motor vehicle operators' license fees composed 1 percent, while investment income was less than 1 percent.

**Figure 2**  
**First Quarter, FY06**  
**Road Fund Receipts**



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# The Economy

## NATIONAL ECONOMY First Quarter, FY06

Real gross domestic product (GDP) is an inflation-adjusted measure of the total output of goods and services produced in the United States. Real GDP is estimated to have increased by 3.5 percent in the first quarter. This continues a relatively stable period of economic growth compared to the previous four quarters, when growth was contained within a narrow range of 3.6 to 3.8 percent.

Consumption accounts for about two-thirds of real GDP. Total real consumption increased by 3.7 percent in the first quarter, compared to 3.5 percent a year ago. Gains in consumption are most pronounced in the durable-goods category which was up 7.7 percent. The growth in this category is still dominated by motor vehicles which were up sharply by 7.0 percent, a result of employee discounts that manufacturers extended to all purchasers. Consumption of other durable products was also up. Furniture and related-goods were up 7.5 percent due to the strength of the housing sector. Consumption of nondurable goods was up 4.1 percent. This category includes essentials like clothing and energy and

usually remains fairly steady. Services comprise over half of all consumption and were up 2.7 percent.

Total investment comprises close to a fifth of real GDP and is usually sensitive to both interest rates and future expansion opportunities. Overall, the investment component of GDP increased by 4.1 percent. Investment in computers and software was the strongest with growth of 9.5 percent.

Government spending constitutes 17 percent of GDP and was up 1.7 percent. This component is driven by defense spending. These have grown by just 1.6 percent in the first quarter compared to a growth of 7.8 percent a year ago.



Industrial production was up by 2.7 percent, after a 1.4 percent increase in the previous quarter. All major areas of production were up especially the mining sector. With the increase in the price of crude oil and the subsequent rise

in all energy products, production in the coal mining sector was up 25.1 percent.

The University of Michigan Consumer Sentiment Index for the first quarter was at 89.2 compared to 95.6 a year ago. This indicates that consumers are worried that higher energy prices will cut into their ability to afford their current level of consumption. Factory capacity utilization continues to be very low (78.4 percent) as lower production costs in Asian countries,

particularly China, make it cost-effective to locate manufacturing plants abroad.

Personal income, a measure of spending power, was \$10,335.5 billion in the first quarter, for an increase of 6.2 percent over one year earlier. While nominally this appears to be good growth, it is only slightly higher than inflation as measured by the Consumer Price Index (CPI).

The unemployment rate in the first quarter averaged 5.0 percent compared to 5.4 percent a year ago. Even though the rate is down, the size of the civilian labor force has grown by 1.8 percent from a year ago. This may be due to new entrants or returnees to the labor market who perceive improving opportunities for hiring. Total nonagricultural employment averaged 133.9 million jobs in FY06:1, an increase of 1.6 percent from the first quarter of FY05. Manufacturing employment is on the decline with a drop of 0.7 percent during the first quarter.

## KENTUCKY ECONOMY

The performance of state economies is measured by personal income and employment. Kentucky's personal income is estimated to be \$121.8 billion for the first quarter of FY06, an increase of 5.9 percent from a year ago. U.S. personal income grew by 6.2 percent during the same period. Wages and salaries constitute a little over half of personal income. Income derived from wages and salaries is estimated to have grown by 5.3 percent in FY06:1, slower than the national average of 6.3 percent.

Employment data is commonly used to gauge the strength of the state's economy, primarily because of its timely availability and its impact on consumer spending and confidence. Nonagricultural employment in Kentucky is estimated to have increased by 22,500 jobs in the first quarter of FY06 compared to one year earlier, resulting in a growth of 1.3 percent. During the decade of the 1990s the average growth rate in

**Table 3**  
**Summary US Economic Conditions**  
**First Quarter\***

	<u>FY05</u>	<u>FY06</u>	<u>Percent Change</u>
Real GDP (billion 2000 \$)	10,808.9	11,187.5	3.5
Personal Income (billion \$)	9,729.2	10,335.5	6.2
Consumer Price Index (percent change)	1.6	5.7	-
Industrial Production (percent change)	2.7	2.7	-
Civilian Labor Force (millions)	147.7	149.7	1.4
Total Nonagricultural Employment (millions)	131.7	133.9	1.6
Manufacturing Employment (millions)	14.4	14.3	-0.7
Unemployment Rate (percent)	5.4	5.0	-

\* Seasonally adjusted data.

Sources: Global Insight, and U.S. Department of Commerce, BEA.



Kentucky's nonfarm employment was 2.3 percent. However, given that productivity rates have increased substantially and there is excess production capacity in China and east Asia, the 1.3 percent increase is quite robust compared to recent history.

One of the largest sectors employment growth, both in terms of numbers and percentage change, was the Contract Construction sector (up 5.2 percent with an increase of 4,300 jobs). The relative strength of construction is from the housing sector which continues to receive a boost from historically low mortgage rates. Business services constitute over eight percent of total nonfarm employment and include temporary help services. The robust growth of 2.0 percent in this sector is associated with the continued reluctance of employers to add permanent full-time staff given the uncertainty in the economy. Leisure and Hospitality services were up 3.0 percent. Most of the gain was in the area of accommodation and food services.

The arts and entertainment portion of this category showed a slight decline.

Historically the focus of Kentucky's economy has been on the manufacturing sector. The newly revised definition of manufacturing makes it the third largest sector in the Kentucky economy after Trade, Transportation, and Utilities and Government. Manufacturing employment accounts for about 15 percent of all nonagricultural employment in Kentucky compared to 11 percent nationally. Over the last four years manufacturing employment declined sharply due to both the relocation of production facilities abroad, and increased domestic productivity. During the first quarter manufacturing saw an uptick with employment increasing by 2,000 from a year ago.

The increased output in mining helped that sector to grow by 4.1 percent from a year ago. Trade, transportation, and utilities account for a fifth of all jobs. This sector showed an increase of 1.1 percent.

**Table 4**  
**Selected Kentucky Economic Indicators**  
**First Quarter, FY06**

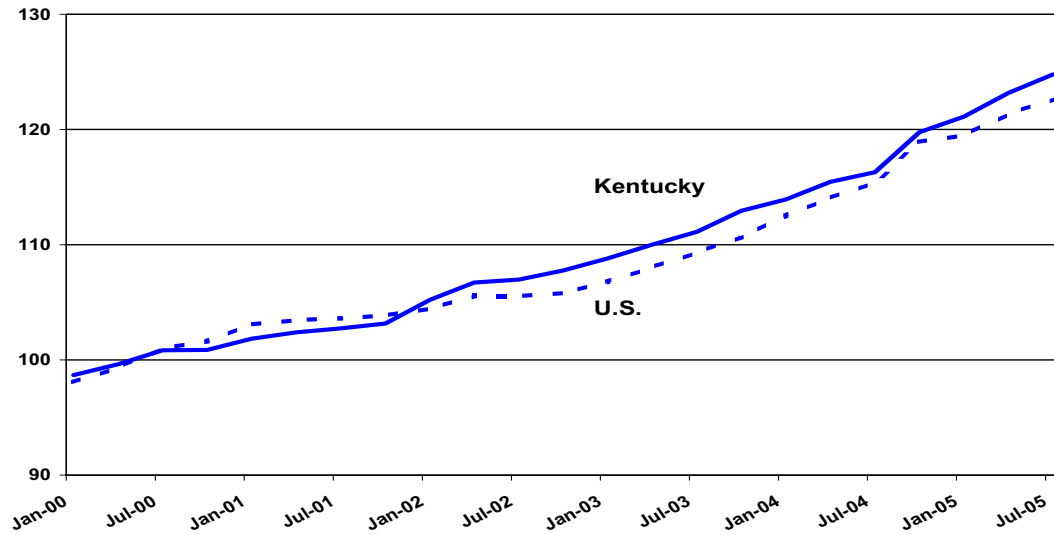
	<u>FY05:1</u>	<u>FY06:1</u>	<u>Change</u>	<u>%Chg</u>
Total Personal Income (\$ millions)	114,945	121,761	6,816	5.9
Wage & Salary Income (\$ millions)	61,403	64,676	3,273	5.3
Total Nonagricultural Employment (000)	1,795.2	1,817.7	22.5	1.3
Contract Construction	82.9	87.2	4.3	5.2
Mining	19.7	20.5	0.8	4.1
Manufacturing	262.6	264.6	2.0	0.8
Trade, Transportation & Utilities	371.9	376.2	4.3	1.1
Information	28.9	28.4	-0.5	-1.9
Finance	87.4	86.0	-1.3	-1.5
Business Services	162.8	166.0	3.2	2.0
Educational Services	231.6	234.9	3.3	1.4
Leisure and Hospitality Services	160.3	165.2	4.8	3.0
Other Services	78.6	78.1	-0.4	-0.6
Government	308.5	310.7	2.2	0.7

Note: Numbers may not add up due to rounding.

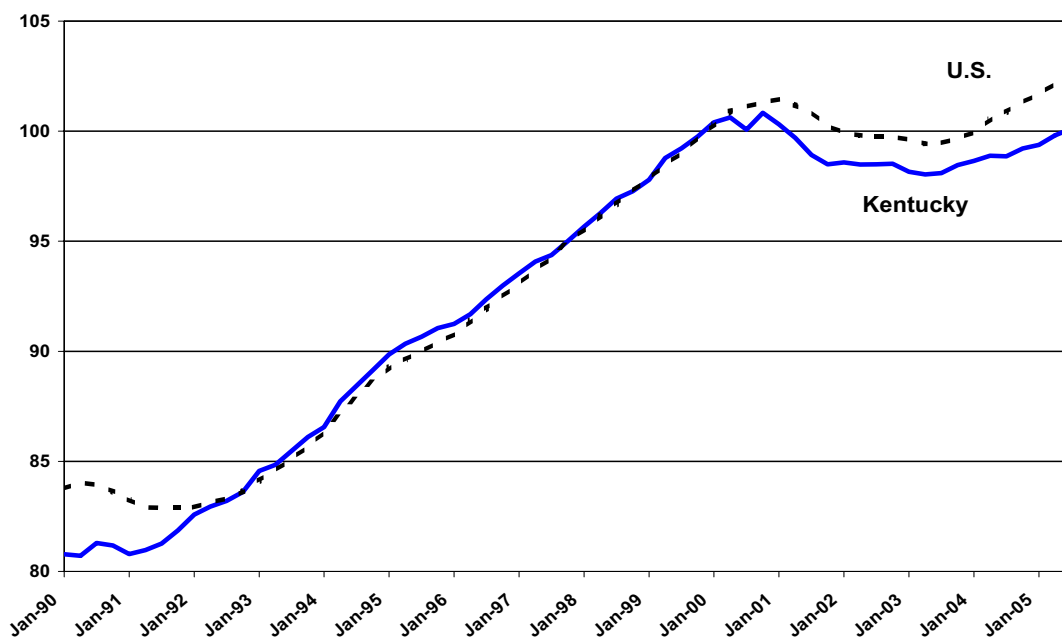
Sources: U.S. Department of Commerce, Bureau of Economic Analysis.

GOEA's Macromodel of Kentucky Forecast, September 2005

**Figure 3**  
**Personal Income: KY vs. U.S.**  
(Index FY00 = 100)



**Figure 4**  
**Nonfarm Employment Growth: KY vs. U.S.**  
(Index FY00 = 100)



# Interim Outlook

Projected General Fund revenues for the next three quarters are shown in Table 5. General Fund revenues were \$1,965.7 million in the first quarter of FY06, a growth rate of 11.6 percent from the same period a year ago. Revenues grew strongly due to both improved economic performance and tax changes enacted by the 2005 General Assembly. First-quarter growth was strongest in the volatile corporation income and license taxes and

adopted by the Consensus Forecasting Group on October 11, becoming the revised consensus revenue estimate for FY06.

The official revenue estimate including changes made by the 2005 General Assembly anticipates General Fund revenues of \$7,825.0 million for FY06. The interim forecast as shown in Table 6 predicts that revenues will be \$8,184.9 million, an increase of \$359.9 million over

**Table 5**  
**General Fund Interim Estimate**  
**(million dollars)**

	FY06 Quarter 1		FY06 Quarters 2,3, & 4		FY06 Full Year	
	Actual	% Chg	Estimate	% Chg	Estimate	% Chg
Sales & Use	685.5	6.4	2,023.3	3.7	2,708.8	4.4
Individual Income	766.8	3.4	2,134.9	-7.0	2,901.7	-4.4
Corporation Inc. & Lic.	209.3	59.2	729.4	51.6	938.7	53.2
Coal Severance	52.3	22.0	158.2	11.8	210.5	14.1
Cigarette (inc. flr stocks tax)	53.3	1,332.5	124.0	317.5	177.3	426.1
Property	53.4	38.6	442.2	1.9	495.6	4.9
Lottery	37.0	-17.8	123.0	5.8	160.0	-0.8
Other	<u>108.1</u>	<u>-4.7</u>	<u>484.1</u>	<u>11.1</u>	<u>592.2</u>	<u>7.8</u>
<b>Total General Fund</b>	<b>1,965.7</b>	<b>11.6</b>	<b>6,219.2</b>	<b>5.7</b>	<b>8,184.9</b>	<b>7.1</b>

cigarette taxes, both of which were affected by the changes in tax law.

Anticipated revenues for the last three quarters of FY06 are \$6,219.2 million, corresponding to a growth rate of 5.7 percent from the previous fiscal year. Growth is expected to be positive in all major accounts except for the individual income tax, which was affected by the changes enacted by the 2005 General Assembly. The interim estimate was

the official estimate. As explained below, most major sources of revenue are expected to grow.

Total sales and use tax receipts for the first quarter of FY06 were \$685.5 million, representing an increase of 6.4 percent from the same period a year ago. The projected rate of growth for the remaining three quarters of FY06 is 3.7 percent. Total sales and use tax receipts for FY06 are estimated to be \$2,708.8 million, or \$8.4 million below the official estimate.

The interim forecast for the individual income tax calls for a drop of 7.0 percent for the remainder of FY06, amounting to collections of \$2,134.9 million in the final nine months. The individual income tax rose by 3.4 percent in the first quarter of FY06, but no growth is expected in the remainder of the fiscal year due to changes enacted by the 2005 General Assembly. Those changes included a reclassification of taxes paid by pass-through business entities (s-corporations, limited liability companies, limited liability partnerships, etc.) from the individual income tax to the corporation income tax, a restructuring of marginal rates to include a rate of 5.8 percent on income between \$8,000 and \$75,000, and an expansion of the low-income credit. For the entire fiscal year, individual income tax revenues are projected to decline by 4.4 percent.

**Table 6**  
**FY06 Interim General Fund Revenue Forecast**  
**Compared to Official Estimate**  
**(mil \$)**

	<b>Interim Estimate</b>	<b>Official Estimate</b>	<b>Dif</b>
Sales & Use	2,708.8	2,717.2	-8.4
Individual Income	2,901.7	3,089.3	-187.6
Corp Inc. & Lic.	938.7	530.0	408.7
Coal Severance	210.5	173.2	37.3
Cigarette (inc. flr stocks tax)	177.3	16.8	160.5
Property	495.6	486.2	9.4
Lottery	160.0	157.5	2.5
Other	592.0	544.8	47.4
Tax Modernization	<u>0.0</u>	<u>110.0</u>	<u>-110.0</u>
<b>General Fund</b>	<b>8,184.9</b>	<b>7,825.0</b>	<b>359.9</b>

The outlook for corporation income and license taxes projects an increase of 51.6 percent in the final three quarters of FY06, representing collections of \$729.4 million. These anticipated collections will bring the FY06 total to \$938.7 million, an increase of 53.2 percent from FY05. Revenues in FY06 are affected by changes to both the corporation income and license tax.

Corporation income tax revenues are expected to be boosted by inclusion of taxes paid by pass-through business entities, an alternative minimum calculation, and closing loopholes. On the other hand, measures that will reduce revenues include a reduction in the top marginal corporation income tax rate from 8.25 percent to 7 percent, and the repeal of the corporation license tax effective January 1, 2006.

The coal severance tax continued its recent resurgent growth in the first quarter, and the forecast is for increases to persist for the remainder of FY06. Growth is forecasted to be robust at 11.8 percent for the remaining three quarters. Overall for the fiscal year, coal severance tax receipts are expected to rise by 14.1 percent.

Cigarette taxes were increased by the 2005 General Assembly, which raised the rate on a pack from 3 cents to 30 cents. (Only 29 cents of the tax accrue to the General Fund). Additionally, a floor stocks tax was imposed on cigarette inventories as of midnight on May 31, 2005. The floor stocks tax was payable in three monthly installments. The July and August payments were received in the current fiscal year. In the first quarter, cigarette tax collections totaled \$53.3 million including the floor stocks tax. The outlook for the remaining nine months of the fiscal year is for \$124.0 million in revenue, with a corresponding growth rate of 317.5 percent. For the entire fiscal year, receipts are forecasted to rise by 426.1 percent and yield \$177.3 million in revenue.

Property tax revenues totaled \$53.4 million in the first quarter of FY06, representing growth of 38.6 percent from a year earlier. Receipts in property tax are sensitive to timing of payments, and in the first quarter

payments of Public Service Company property taxes were received earlier than in the previous year. It is expected that the remaining three quarters of FY06 will yield total property tax revenues of \$442.2 million, for a growth of 1.9 percent from the previous year. Growth for the entire fiscal year should average 4.9 percent.

Lottery revenues fell by 17.8 percent in the first quarter of FY06. The decline was a result of unexpected revenues received in the first quarter of FY05, when Powerball sales boosted revenues to the state. In the next three quarters, lottery revenues are expected to rise by 5.8 percent. For the entire fiscal year, lottery receipts should fall by 0.8 percent.

The “other” category contains estimates for several of the smaller revenue sources not otherwise classified. During the final three quarters of FY06 this category should experience growth of 11.1 percent. Strong growth is anticipated due to several measures: the creation of new taxes by the 2005 General Assembly including a tax on other tobacco products, a telecommunications excise tax, and a telecommunications gross receipts tax;

increased enforcement revenue; and redirecting abandoned property receipts to the General Fund.

## ROAD FUND

Road Fund revenues over the three-quarter horizon are forecasted to grow by 4.8 percent as shown on Table 7. This represents an increase of \$29.4 million from the official revenue estimates including legislation enacted by the 2005 Kentucky General Assembly.

Motor fuels tax receipts are forecasted to grow by 6.8 percent in the last three quarters of FY06. This is principally due to a change in forecasted gasoline prices and their effect on the statutory rate of the motor fuels tax. Gasoline prices have averaged higher than expected thus far in the fiscal year; the resulting tax rate will be higher than was anticipated in the official estimates.

Motor vehicle usage tax collections are expected to rise by 1.2 percent in the final three quarters of FY06. Receipts in the first quarter were strong at 7.4 percent. Growth is not expected to be maintained as

**Table 7**  
**Road Fund Interim Estimate**  
**(million dollars)**

	FY06 Quarter 1		FY06 Quarters 2,3, & 4		FY06 Full Year	
	Actual	% Chg	Estimate	% Chg	Estimate	% Chg
Motor Fuels & MF Use/Surtax	135.6	6.8	388.6	6.8	524.2	6.8
Motor Vehicle Usage & Rental	117.6	7.4	301.7	1.2	419.3	2.9
Motor Vehicle License	16.4	-2.6	76.8	2.3	93.2	1.4
Motor Vehicle Operators	3.3	99.6	12.6	196.3	15.9	169.5
Weight Distance Tax/Surtax	21.6	4.1	63.8	2.4	85.4	2.8
Investment	0.7	-19.7	3.1	-33.1	3.8	-30.9
Other	9.5	2.1	34.0	4.5	43.5	4.0
<b>Road Fund</b>	<b>304.7</b>	<b>6.6</b>	<b>880.6</b>	<b>4.8</b>	<b>1,185.3</b>	<b>5.2</b>

the popular employee discounts and other incentives are discontinued or scaled back, affecting sales of new cars.

To estimate the growth of all other components of the Road Fund, officials of the Kentucky Transportation Cabinet and staff of the Governor's Office for Economic Analysis together assessed recent growth patterns as well as administrative and statutory factors. Motor vehicle license taxes are forecasted to grow 2.3 percent in

the final three quarters of FY06. Motor vehicle operators' licenses are projected to rise by 196.3 percent in the remainder of the fiscal year due to a statutory change in drivers' license fees from \$8 to \$20. Weight distance tax revenue should improve by 2.4 percent for the remainder of the fiscal year. Investment income should decline by 33.1 percent due to lower fund balances. All other revenues should combine for growth of 4.5 percent during the last nine months of FY06.

**Table 8**  
**FY06 Interim Road Fund Revenue Forecast**  
**Compared to Official Estimate**  
**(mil \$)**

	<u>Interim Estimate</u>	<u>Official Estimate</u>	<u>Dif</u>
Motor Fuels & MF Use/Surtax	524.2	504.6	19.6
Motor Vehicle Usage & Rental	419.3	415.6	3.7
Motor Vehicle License	93.2	93.3	-0.1
Motor Vehicle Operators	15.9	17.0	-1.1
Weight Distance Tax/Surtax	85.4	84.9	0.5
Investment	3.8	3.8	0.0
Other	<u>43.5</u>	<u>36.7</u>	<u>6.8</u>
<b>Road Fund</b>	<b>1,185.3</b>	<b>1,155.9</b>	<b>29.4</b>



## NATIONAL ECONOMY

The impact of Hurricane Katrina and the resulting spike in energy prices are expected to play a major role in the nine month period from October 2005 to June 2006. Purchase of energy-related items will take a larger share of consumption, leaving less for other items.

Real GDP is expected to show a gain of 3.4 percent from a year ago during the October-to-June period of FY06. This is slightly lower than the 3.7 percent growth experienced during the same period in FY05. Employment in nonfarm industries is forecasted to be up by 1.6 percent, about the same as the 1.7 percent increase during the same period last year. Employment in mining and construction will continue to grow rapidly fueled by high energy prices and low long-term interest rates, respectively. However, both these employment sectors are relatively small and together constitute just 5 percent of total nonfarm employment. Among the large sectors, business services are expected to expand by 3.3 percent and leisure and hospitality by 2.4 percent.

Manufacturing employment is forecasted to decline by 0.6 percent

Over the last three years consumption has played a greater role in real GDP as the other components—investment, net exports, and government spending—have been hit by overcapacity, the strong dollar, and state government budget woes which have counterbalanced federal government spending. During the next three quarters of FY06 consumption is expected to increase by 2.8 percent compared to 3.7 percent a year ago. Consumption of durable goods is expected to soften substantially from 5.5 percent a year ago to 1.8 percent. The dampening is related to slowdown in the consumption of motor vehicles and parts from 2.0 percent during the last three quarters of FY05 to -3.3 percent in FY06.

Investments are expected to show continued strength by going up 8.2 percent. The main driver for this growth is investment in business equipment and software which is forecasted to increase by 10.2 percent. Investment in structures is expected to be boosted by 10.1 percent due

**Table 9**  
**U.S. Economic Outlook for FY06**  
**Quarters 2, 3, & 4**

	<u>FY05</u>	<u>FY06</u>	<u>Percent*</u> <u>Change</u>
Real GDP (billion 2000 \$)	10,995.0	11,370.4	3.4
Personal Income (billion \$)	10,108.9	10,714.4	6.0
Consumer Price Index (%change)	192.4	199.1	3.5
Industrial Production (1992=100)	118.0	121.3	2.8
Civilian Labor Force (mil)	148.4	150.8	1.6
Total Nonagricultural Employment (mil)	132.8	135.4	1.9
Manufacturing Employment (mil)	14.3	14.2	-0.6
Unemployment Rate (percent)	5.3	5.0	-

\*Seasonally adjusted annual rate.

Sources: Global Insight, and U.S. Department of Commerce, BEA.

Data for FY06 are September 2005 estimates.

partly to the rebuilding efforts in the hurricane-hit Gulf region. During FY06 both Europe and Asia are anticipated to have robust economies. This is expected to boost exports by 7.8 percent. Growth in imports is expected to lag exports because of the continued weakness of the dollar. Government purchases are forecasted to increase by 2.2 percent in the last three quarters of FY06—slightly stronger than last year's 1.9 percent.

U.S. personal income is forecasted to increase by a robust 6.0 percent as employment strengthens. In spite of higher energy prices, inflation is expected to be kept in check from increased productivity to 3.5 percent.

## **KENTUCKY ECONOMY**

The impact of the national recovery will be felt in the state economy. However, since the goods-producing sectors dominate the state economy, the national average will be slightly higher than the state average. Personal income is estimated to increase by 5.1 percent during the October-to-June

FY06 period compared to a 6.0 percent increase nationally.

Kentucky's nonagricultural employment is expected to grow strongly during the final three quarters of FY06 with a gain of 1.3 percent. The job growth is anticipated to come from the goods-producing sector which includes mining, construction and manufacturing. The combined growth in these sectors is estimated at 0.9 percent, resulting in 3,150 new jobs. The service-providing industries are forecasted to expand by 1.5 percent with the creation of 16,600 jobs. Employment in government—including federal, state, and local—is anticipated to rise by 1.2 percent.

Business services are expected to post the strongest gains with an increase of 2.3 percent. The construction industry is expected to remain strong. Even though interest rates are expected to rise further in FY06, the rates are still near historical lows. With the strengthening of the economy and income, the housing sector is expected to remain strong. The slight gain in mining is related to high natural-gas prices and the consequent increased demand for coal.

**Table 10**  
**Kentucky Economic Outlook for FY06**  
**Quarters 2, 3, & 4**

	<u><b>FY05</b></u>	<u><b>FY06</b></u>	<u><b>Percent*</b></u> <u><b>Change</b></u>
Total Personal Income (\$ millions)	119,928	126,089	5.1
Wage & Salary Income (\$ millions)	63,915	67,227	5.2
Total Nonagricultural Employment	1,806.1	1,829.6	1.3
Contract Construction	85.6	88.1	3.0
Mining	20.0	20.7	3.7
Manufacturing	265.0	264.8	-0.1
Trade, Transportation & Utilities	373.4	378.1	1.3
Information	28.2	28.6	1.3
Finance	85.7	86.2	0.5
Business Services	165.1	168.9	2.3
Educational Services	232.5	236.6	1.8
Leisure and Hospitality Services	163.1	166.5	2.1
Other Services	78.5	78.3	-0.3
Government	309.0	312.8	1.2

\* Seasonally adjusted rate from a year ago.

Source: GOEA's Macromodel of Kentucky, September 2005



## APPENDIX





**KENTUCKY STATE GOVERNMENT REVENUE  
GENERAL FUND REVENUE**

	First Quarter 2005 - 2006	First Quarter 2004 - 2005	% Change
<b>TOTAL GENERAL FUND</b>	<b>1,965,737,395</b>	<b>1,761,382,454</b>	<b>11.6%</b>
Tax Receipts	1,907,344,153	1,687,477,801	13.0%
Sales and Gross Receipts	792,685,901	694,773,787	14.1%
Beer Consumption	1,501,640	1,834,769	-18.2%
Beer Wholesale	10,394,423	10,529,852	-1.3%
Cigarette	41,199,320	3,998,091	930.5%
Cigarette Floor Stock	12,110,939	0	---
Distilled Spirits Case Sales	17,632	22,259	-20.8%
Distilled Spirits Consumption	1,973,910	2,290,634	-13.8%
Distilled Spirits Wholesale	4,563,845	4,231,686	7.8%
Insurance Premium	32,247,913	25,143,608	28.3%
Pari-Mutuel	902,130	18,718	4719.5%
Race Track Admission	128,061	98,983	29.4%
Sales and Use	685,484,466	644,410,695	6.4%
Wine Consumption	390,530	480,682	-18.8%
Wine Wholesale	1,771,093	1,713,810	3.3%
License and Privilege	79,787,880	66,393,454	20.2%
Alc. Bev. License Suspension	46,400	62,250	-25.5%
Coal Severance	52,319,160	42,893,672	22.0%
Corporation License	14,925,796	13,491,055	10.6%
Corporation Organization	68,200	20,343	235.3%
Occupational Licenses	26,285	56,981	-53.9%
Oil Production	1,609,065	1,018,703	58.0%
Race Track License	161,350	159,500	1.2%
Bank Franchise Tax	(189,622)	209,290	-190.6%
Driver License Fees	161,814	142,542	13.5%
Minerals Severance	4,232,587	3,699,847	14.4%
Natural Gas Severance	6,426,845	4,639,272	38.5%
Income	961,195,126	859,627,916	11.8%
Corporation	194,368,013	118,017,026	64.7%
Individual	766,827,113	741,610,890	3.4%
Property	\$53,439,676	\$38,562,112	38.6%
Bank Deposits	0	0	---
Building & Loan Association	168,529	71,384	136.1%
Distilled Spirits	74,184	0	---
General - Intangible	5,765	3,830	50.5%
General - Real	344,656	223,100	54.5%
General - Tangible	22,402,585	21,721,551	3.1%
Omitted & Delinquent	8,037,930	4,756,291	69.0%
Public Service	22,405,909	11,770,126	90.4%
Other	117	15,830	-99.3%
Inheritance	\$11,216,202	\$19,159,561	-41.5%
Miscellaneous	\$9,019,369	\$8,960,970	0.7%
Legal Process	6,816,915	6,934,139	-1.7%
T. V. A. In Lieu Payments	2,181,146	2,026,831	7.6%
Other	21,308	0	---
Nontax Receipts	\$56,511,143	\$72,561,686	-22.1%
Departmental Fees	5,535,995	5,967,308	-7.2%
PSC Assessment Fee	8,367,263	11,033,008	---
Fines & Forfeitures	6,608,006	6,580,721	0.4%
Interest on Investments	235,151	241,201	-2.5%
Lottery	37,000,000	45,000,000	-17.8%
Sale of NOx Credits	136,000	3,230,425	-95.8%
Miscellaneous	(1,371,271)	509,023	-369.4%
Redeposit of State Funds	\$1,882,099	\$1,342,967	40.1%

**KENTUCKY STATE GOVERNMENT REVENUE  
ROAD FUND REVENUE**

	First Quarter 2005 - 2006	First Quarter 2004 - 2005	% Change
<b>TOTAL ROAD FUND</b>	<b>\$304,684,105</b>	<b>\$285,905,432</b>	<b>6.6%</b>
Tax Receipts-	\$296,799,824	\$278,302,380	6.6%
Sales and Gross Receipts	\$253,192,423	\$236,517,847	7.1%
Motor Fuels Taxes	130,255,075	121,870,316	6.9%
Motor Fuels Use & Surtax	5,235,418	5,000,986	4.7%
Truck Trip Permits (fuel)	92,440	134,165	-31.1%
Motor Vehicle Usage	117,609,489	109,512,380	7.4%
License and Privilege	\$43,607,401	\$41,784,534	4.4%
Motor Vehicles	16,390,608	16,825,955	-2.6%
Motor Vehicle Operators	3,257,331	1,632,019	99.6%
Weight Distance	21,628,265	20,786,727	4.0%
Truck Decal Fees	44,219	131,528	-66.4%
Other Special Fees	2,286,978	2,408,305	-5.0%
Nontax Receipts	\$7,025,895	\$7,457,676	-5.8%
Departmental Fees	4,234,352	4,465,873	-5.2%
In Lieu of Traffic Fines	333,281	369,304	-9.8%
Highway Tolls	1,589,008	1,632,219	-2.6%
Investment Income	723,912	899,852	-19.6%
Miscellaneous	145,343	90,428	60.7%
Redeposit of State Funds	\$858,386	\$145,376	490.5%



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**1      *Executive Summary***

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**3      *Revenue Receipts - First Quarter 2006***

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**7      *The Economy***

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**11     *Interim Outlook***

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**21     *Appendix: First Quarter Receipts***

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